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Private Law Aspects of the Nord Stream Pipeline

The initiators of this conference have suggested to concentrate my deliberations on contract rather than tort law, as the environmental liability aspects have been adequately covered by the distinguished speakers already heard, and to distinguish between the construction and the operation phases. In order to review the contractual relations without going deeply into the provisions of the various national laws applicable to the situations, I should like to concentrate on the main work fields of the pipeline comprising of

- construction and repairs
- financing
- transportation
- maintenance
- officers and staff
- compliance
- insurance.

For all of the above issues, the contractual lawyer will rely on elaborate contractual forms which are in use for national and international business and which will usually be based on Anglo-American law even if a negotiated choice of law might finally lead into a continental law system. We may just recall that the project company is a Swiss-based plc and that – according to the map presented on the Nord Stream website – the pipeline starts on Russian soil near Vinby (near Kaliningrad), continues through her territorial waters and into the continental shelf zone, then passes through the shelf zones of Finland, Sweden and Denmark and finally comes through the shelf zone and territorial waters of Germany to end on German soil at Lubmin (near Greifswald).

Regardless of the respective residual legal system of final relevance, any contract will have to pay due respect to the factual purpose of and the legal requirements for the contract. Most of the legal requirements will be based in public law and ordre public considerations, cf. Art. 6 German EGBGB and Art. 9 Rome I- Regulation EC 593/2008. Of course, in general we are talking not of consumer, but of commercial contracts here, and there is more freedom for the latter, but there are also specific other restrictions e.g. under antitrust law. Overstepping any such binding legal requirement and boundary may invalidate a contravening contractual provision and even the whole contract; there is a considerable risk that a given forum may apply its home law or its principles or at least its ordre public as well as any chosen law, so that in our case we cannot solely rely on the contractual choice of law.

Keeping in mind these caveats, we may now continue into the contracts in the fields of activity of the pipeline company.
1. Construction, repairs

Construction and repairs comprise of planning, purchase of materials (e.g. pipes, concrete) and machinery (e.g. pipelaying barge), purchases of services (e.g. transportation) and purchases of results.

The first question is whether the Nord Stream AG is under a procurement regime. It is not a public company by itself, but the majority of the main shareholder Gazprom is held by the Russian state. Russia is neither a party to the International Convention/Rules on Public Procurement and nor an EC public entity. Nord Stream AG does not operate under an exclusive or a special licence of an EC state. Its activities in the Exclusive Economic Zones (Art. 55-57 UN Convention on the Law of the Seas, UNCLOS) or, respectively, the Continental Shelf (Art. 76, 83 UNCLOS) do not fall under the jurisdiction of the adjacent coastal state, which is restricted to the Coastal Waters (see Art. 2, 3 et seq. UNCLOS), specially named activities outside this area and an ascertainment of unnoxiousness of the project, as we have already heard from the previous speakers. Of course, as a Swiss company Nord Stream AG will have to observe Swiss law.

The second point will be the consideration of all licences granted to the project and the proviso that all licence conditions will be properly met. We have already heard some deliberations on the ramifications of the rights of the coastal states under UNCLOS; I just wonder why the licence procedures cannot be abbreviated by reference to the results of the strictest assessment and licencing procedures, as the multiple scrutiny of the same issues comes close to an abuse of public positions.

Let us now concentrate on the private law contractual issues. There is no room for BOT, BOO or similar contracts, but the owner will bear the full cost and ultimate responsibility for this truly international project which is politically very sensitive and technically quite demanding. The owner takes care of the financing because of its particularly good standing derived from

- the shareholders (Gazprom with 51 %, Wintershall and Eon Ruhrgas with 20 % each, Gasunie with 9 %) and their long-term interests in gas export resp. import, each with importing interests).
- the substantial operational cash income from gas transportation fees.

In contrast to many other industrial projects, here only the project company and its shareholders have the competency to deal with the multitude and complexity of

- the ultimate business which is long-term international gas trade between the shareholders rather than the mere operation of a transportation system,
- the international ramifications of such tradings and transportation, and
- the fully reliable long-term operation of a high-tech pipeline project.

In consequence, only the project company and its shareholders bear the ultimate risks in this project in which – in view of the political sensitivities, the shareholders’ standing as guarantors of reliable European gas supply companies, and the specific technical characteristics of the project - each single step of construction and operation does not forgive failures, mistakes or fault. The project does not allow for a considerable shift of any risk to contractors or financial guarantors: The pipeline has to function, period.

There is hardly a remedy to cure technical problems, once the pipes are based in the seabed and covered by concrete. The gas will go into the pipeline in Russia at a pressure of ca. 200
atmosphere/bar and will come out of the pipe in Germany with a pressure of ca. 100 atmosphere/bar.

The timetable of the project must be kept as there will be pipeline front and rear risks arising from gas supply contracts, e.g. take-or-pay clauses in the purchase contracts and similar clauses in the gas sale contracts for the gas to be transported by the pipeline.

The good result will depend on
- a permanent flow of information, e.g. access to and controls of the various steps of the manufacturing and pipe-laying processes by the project company, the general contractor, the manufacturers themselves, the service specialists etc.,
- a sufficient flexibility of all contract partners involved, e.g. to fasten or slow work progress,
- a reliable real-time documentation of works and controls.

In consequence, there will be complex and co-respective main obligations on all partners, for which there is only fulfilment in kind, while the number of ancillary obligations, which may be breached with financial consequences only, will be relatively reduced.

In comparison, guarantees, payment schedules, security interests and the like, will be of minor importance in the negotiations, although covering high numbers. The same is true for the clauses for conflict prevention and resolution, jurisdiction, choice of law etc. A respectable adjudication procedure during the project, so that it can be continued without delays, is much more important than any later process for the allocation of monetary damages.

The pipeline project must succeed, there are no second chances. This is the principle governing the making and the operation the pipeline, and you will find this central challenge in any business decision.

2. Financing

Nord Stream AG says that their financing will be roughly 30 % equity and 70 % loans. We may assume that the credit will be raised internationally in London.

a) Cash flow

As with any project financing, the proceeds to cover the cost of financing will stem from the operational cash flow of the project; here, it is the income from gas transportation fees. The security of this income will be judged
- with regard to the transportation service and the fee currency from the shareholder agreements, which may provide for preferential use and conditions of transport, and the potential for third party interference like third party access (TPA) to the pipeline and/or competing parallel pipeline projects,
- with regard to the ultimate source of any transportation fees from the development of Russian supplies for export and of the West European market for gas.

Even if the prospects for the future cash flow are good, the banks may seek additional security, be it in the form of guarantees by the shareholders, be it in form of a security interest in the fees, be it in form of an encumbrance of the pipeline.
The assignment or encumbrance of fee claims will be under the law of the fee claim, cf. Art. 33 German EGBGB and Art. 14 Rome I – Regulation EC 593/2008. The fee claims can be under Swiss law as is the operator, but alternative national laws may be applicable by stipulation in the transportation contract and/or under TPA rules, which should primarily lead to the usual conditions, i.e. the law of the usual transportation contract, and secondarily to the law of the state granting access.

b) Pipeline

The latter raises a particularly delicate subject as it is not quite clear under which law the property of the pipeline is acquired. The law of the governing jurisdiction will determine whether the property concerns movable or immovable property, which form and sort of encumbrance the property may allow, and how the property or its value will secure the credit. For our case of a transnational pipeline assembled outside the Territorial Waters, UNCLOS does not give guidance other than that

- at the High Seas there is the full freedom to erect artificial structures and to lay pipelines (Art. 87 lit. d, c; Art. 112 UNCLOS),
- in the Exclusive Economic Zone there is a right under the sovereignty of the coastal state to erect artificial structures (Artt. 60, 56 para 1 lit b.i. UNCLOS) and the freedom to lay pipelines (Art. 58 UNCLOS),
- on the Continental Shelf (Art. 76 UNCLOS) there is a right under the sovereignty of the coastal state to erect artificial structures (Art. 80 UNCLOS) and the freedom to lay pipelines under a certain privilege and control of the coastal state (Art. 79 UNCLOS).

The restricted sovereignty, if any, of the coastal state means that in contrast to the situation in Coastal/Territorial Waters it may not impose its private law on the pipeline. In consequence, the principle of lex rei sitae (cf. Art. 43 German EGBGB) may not lead to a competent jurisdiction. Elsewise the rules of conflict only refer to the closest connection (cf. Art. 46 German EGBGB). This is difficult to determine, as it will depend on the applicable law or a questionabile prequalification whether the pipeline – though immovable after construction - is regarded as an immovable property or – like usually a deep sea cable – as chattel (cf. e.g. the old German law on the encumbrance of deep sea cables of March 31, 1925, RGBl. 1925 I 37).

The established international practice is of limited help either:

Oil and gas exploration platforms are mostly movable and thus are registered under a flag lie ships. The same applies to artificial islands. However, oil and gas gathering pipelines are considered as ancillary structures and share the status of their main platforms. Wherever a couple of platforms share a pipeline, they are usually in the same waters and the same flag state, thus sharing jurisdiction. The reason for the sharing of the flag lies in the fact that the Offshore platforms are either in the territorial waters or in the Exclusive Economic/Continental Shelf Zone of a coastal state; under the UN Convention of the Law of the Seas, the coastal state has the right to exclusive use of the natural resource in the sea, grants the concessions and accordingly exercises the jurisdiction over the installations.

Applying this principle to our situation might lead into the Russian jurisdiction. The compressor is installed on Russian soil, and there is no further platform for the length of the pipeline. However, in our case the pipeline is the main item, and the compressors have the ancillary function to enhance pipeline capacity. The compressor may be exchanged for one or a couple with another capacity and/or another location. Apart from the evidential placement
of the compressor on the pipeline route, it is not convincing to state that because of such accidental facts one or a couple of auxiliary installations determine that the pipeline is under the jurisdiction of their placement state(s). Even if we contemplate the start of the pipeline on Russian soil, it may not be justified to expand the property from there; the smallest part of the pipeline is in the Russian territory, the conveyance of title to the pipes will take place as stipulated in the purchase contracts, and the formation of a single pipeline by welding the pipes together will take place in the high sea.

Moreover, the ownership for the compressor station(s) and the pipeline must not necessarily coincide. At least in theory, compressing could be provided as a service by a company in the exporting state.

Finally, it may be questionable, whether it is in the best interest of the Swiss project company and an encumbrance of the pipeline to acquire and maintain property rights under Russian law. The financing from London will be under Western, preferably English law.

In consequence, the transnational pipeline has a debatable property status.

Even an analogy to the status of deep sea cables will not help decisively. Usually they are considered as ancillary installations to the sending station and thus share its domicile. This has historic reasons, as the cables were acquired and taken on board in the sending state and were laid from the sending state to the state of destination, thus carrying along their legal affiliation. Of course, the state of destination may use – by installing a sending station of its own - the cable for transportation of electric signals (back) to the state of origin; but this would not alter the status of the cable. Moreover, the main problem has historically been the regulation of the contents provided via the cable, and this was primarily done by the respective sending state. Today, matters are more complicated: The essential facility doctrine in its respective scope under the jurisdictions involved, might provide a right of access for third parties, which may put the jurisdictions into conflict with each other; however, the right of access may be granted to any property qualifying as an essential facility and regardless of the property issues (cf. also Art. 43 II German EGBGB); in reality, such forced access seems not to be a main problem for cables, as there are alternative routings including those via satellite.

So we have to turn back to the nature of the transnational pipeline for a solution of the legal problem.

The least acceptable solution is to place the pipeline under the lex rei sitae in such a way, that the law of the respective state territory or of the respective Exclusive Economic/Continental Shelf Zone is applicable. This would result in a fractioning of the property and would constitute a serious impediment to the right of laying cables and pipelines under UNCLOS (cf. Art. 57??). We also do not have the case that the pipeline is constructed onshore and then brought on the high sea, along with its property status. As the main part of the pipeline will be assembled offshore outside territorial waters, a connection with the nationality of the laying barge or the seat of Nord Stream AG in Switzerland seems rather not so significant.

The Energy Charta Treaty has proposed a model convention for transnational pipelines, but this shall apply to land pipelines, where the property regime is defined by the principle of territoriality.

Therefore, I should like to propose to have the transnational deep-sea pipeline of Nord Stream AG registered in the ship register of the flag state, cf. Art. 45 German EGBGB. The require-
mention of a genuine link between the ship and its flag state under Art. 91 para 1 sentence 3 UNCLOS limits the choice of the flag state. The entry into the ship registry will be manifest, allows to view the pipeline as territoire flottante (Art. 92, 91 UNCLOS) and to apply the property rules of the flag state, e.g. for the classification as mobile or immobile property, the determination of ways for legal encumbrance and the acquisition, use and execution of such liens. If the ship register of the flag state lacks a special category for the pipeline, it may be classified as a submarine or submarine structure in accordance with its transportation purpose, nature, and risks. Moreover, registration by the flag state provides for jurisdiction and applicability of minimum standards (Art. 94 UNCLOS) and renders the chance of diplomatic protection of the property, which is essential in view of the transnational route of the pipeline and the claims of the coastal states (see also Artt. 113-115 UNCLOS with regard to liabilities).

3. Transportation

The core business of the project will be the conclusion and fulfilment of gas transportation contracts. They will have to be awarded according to a project business plan, which will have to observe a merit order for transportation based especially on
- the shareholder agreements giving preferential transportation rights,
- the necessities of gas transportation as e.g. advance booking times, gas characteristics, gas volumes (fixed or flexible; duration), economic considerations (fee structure, take-or-pay-obligations for the transportation good), security of supply considerations,
- legal requirements for TPA and pertaining transparency and non-discrimination obligations,
- use-or-lose and first-come-first-served rules,
- assignability of claims for transportation,
- fee structure,
- damages.

The determination of the national law applicable to the transportation contract is a contractual matter (cf. Art. 27 German EGBGB; Art. 3 Rome I – Regulation (EC) 593/2008) and may refer to Swiss law in view of the incorporation and seat of the project company, Russian law in view of the input state, German law in view of the output state, English law in view of the rules for financing, the flag state law in view of the status of and jurisdiction for the pipeline. The two main aspects for the choice will be the attachment of national and supranational regulation, the ease of the pipeline system and its merit order, and the acceptability for the transportation customers. In view of an express stipulation there will be no room for secondary selections of the law applicable to the transportation contract as e.g. under Art. 5 Rome I – Regulation EC 593/2008.

A special point will be the regulatory and antitrust requirements for the pipeline use, as it may be qualified as a bottle-neck-facility under the essential facilities doctrine. The EC claims for application of EC Regulation 1775/2005 on access to gas grids, the EC Treaty antitrust provisions and the EC Gas Market Directive 2003/55/EC. However, the pipeline starts on Russian territory, and under UNCLOS the Exclusive Economic/Continental Shelf Zones do not give the general territorial rights but rather only specific preferential rights (for exploitation) and obligations (for environmental protection). Furthermore, there is no physical way for third party access on the sea route. When the pipeline reaches German territory, whatever has happened before, cannot be undone: Any competition effects are final. There are no decisions to be taken on German or EC soil. The gas, which is in the ownership of seller or purchaser
but not of the transportation company, is coming out of the pipe at 100 bar; it may not be
taken. The transportation fee is settled outside the EC. The pipeline will perhaps not even be
registered in the German ship registry. The EC shareholders are even together in a minority
(49 %) position and cannot be held responsible for the policies of the pipeline company. In
consequence, there is hardly a genuine link allowing for the oppression of EC law to the
operation of the pipeline.

Now, the EC offers financial help with the funds for enhancement of security of supply by
interconnectors and transnational lines; obviously, many projects as listed in the 2nd Strategic
Energy Review are not or not yet economically viable, and the inclusion of the North Stream
project may show the beneficial nature of the EC involvement as well as give the opportunity
to extend the regulatory and antitrust provisions to this project by stipulations in the funding
contract: *Suventionem accipere est libertatem vendere.*

4. Maintenance

Maintenance is a make-or-buy decision of the project company. So we may refer to the
chapters on construction (1.) and staff (5.). As the main part of the pipeline will run through
the Economic Exclusive/Continental Shelf Zones, the public law requirements and the
applicability of national technical rules and standards are not totally clear; the ascertainment
of non-noxiousness of the project by the coastal state under UNCLOS is mainly restricted to
the installation of the project. Here, registration with a flag state (cf. 2.) may clarify again the
jurisdiction and the applicability of norms and procedures.

There may be obligations taken by the company more or less voluntarily in the assessment
and application procedures. Furthermore, the insurance contracts (for hull, interruption of
business, and third party liability, cf. 7.) may put economic and contractual pressure to adhere
to best industry practices and specific standards.

As we have heard from Mr. Lange of Nord Stream AG the most effective impetus to observe
the strictest standards is the market, economic, and political necessity to get and keep the
project going well and contributing to the security of supply (cf. 1.). This goes far beyond
simple compliance (cf. 6.) and calls for company security standards.

5. Officers and staff

Nord Stream AG is founded and organized under Swiss law and has headquarters in Zug,
Switzerland. In consequence, the company and its officers have to observe Swiss law, and
any and all employment contracts will be under Swiss law. However, there may be employ-
ment contracts with staff to be fulfilled on the pipeline, e.g. on the compressor station on
Russian soil, on maintenance barges or their harbours, or – mainly during the construction
phase – on a supply station for pipes or other materials. In such cases, compulsory national
employment rules have to be observed. Furthermore, in case of temporary or regular work
in another state than the employment state difficult questions of alignment of social security
and tax duties and claims may arise. For the principles for the choice of law for the employment
contract cf. Artt. 30 and 6 German EGBGB and Artt. 8 and 9 Rome I – Regulation EC
593/2008. In this context the flag state of the pipeline will be of less relevance than e.g. the
place of business establishment or the flag of the maintenance barge (see Art. 94 para 3 lit b.
and para 4 UNCLOS).
6. Compliance

It is evident that Swiss company law and accounting rules, the Swiss general rules on corporate governance and the specific company codes are applicable. For antitrust law, we shall refer to Switzerland, but we also have to keep in mind that EC and other national rules may call for attention under the effects doctrine, a non-Swiss place of operation and personal jurisdiction on shareholders (cf. 3.); similar considerations may be available for specific energy law rules. In these fields, there is a high potential for a collision of political wishes, economic necessities, insensitive over-reaching of dogmatic principles, and concerns hiding administrative ambitions, each of them in whatever form as a rule or a ruling it may take.

For compliance, a wide view will also comprise technical safety, labour and environmental standards, rules, and regulations (see also Art. 79 paras 2 and 3 UNCLOS), although it already seems that in these respects Nord Stream operations will be outdone by none.

7. Insurance

Risk management covers two areas: Risk minimization and risk re-shifting. Practically regardless of legal provisos, there will be amongst others
- factual risk management by selection of technical choices and economic measures,
- contractual and compliance risk management,
- contractual risk reduction (information and control rights) and re-allocation mechanisms (damage claims and penalties),
- hedging as a tool of liability risk reduction in case of transportation failure.

Insurance contracts will provide cover for d&o liability and for the pipeline with regard to hull, interruption or loss of business operation/transportation function, and third party liability. Most of these contracts will based on model contracts, which just have to be adjusted to the specifics of the Nord Stream project, a couple of which have already been considered. Due to the volume and specific nature of these contracts, statutory rules of conflict as Art. 37 No. 4 German EGBGB and Art. 7 Rome I – Regulation EC 593/2008 should not come into play.

Thank you for your kind attention.